S&P Global Ratings

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Research Update:

Suzano Outlook Revised To Stable From Negative On Likely Stronger Cash Generation Amid Higher Prices; Ratings Affirmed

March 2, 2021

Rating Action Overview

- Recovery in pulp prices in 2021 should accelerate Suzano's deleveraging. We estimate the 2021 pulp prices in China to be about 25% higher than in 2020.
- As a result, S&P Global Ratings expect Brazilian pulp and paper producer, Suzano S.A., to reduce its leverage metric to below 3.0x in 2021 and 2022.
- On March 2, 2021, we revised our outlook on the company to stable from negative. We also affirmed our 'BBB-' ratings on the company.
- The stable outlook reflects the expected improvement in the company's cash flows and leverage metrics thanks to its efforts to reduce leverage during the past 18 months. We expect Suzano to benefit from better pulp prices and foreign-exchange FX conditions, and to post net debt to EBITDA below 3.0x in 2021 and 2022.

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Rating Action Rationale

Higher pulp prices and the company's efficient cost structure should boost cash flows during the next few years. Suzano's sequential price increase announcements during the past few months, especially in China to $720 per ton from $460, suggest a faster-than-expected price recovery during 2021. This, and our projection of a weaker Brazilian real than last year, prompts us have more confidence about the company's ability to post strong EBITDA in 2021. We estimate the 2021 EBITDA at about 50% higher than in 2020, leading to net debt to EBITDA below 3.0x in the second half of 2021, compared with 4.7x in December 2020.

Construction of a new pulp plant might be announced during 2021. Although Suzano has not officially disclosed plans for a new plant, we view the company as well positioned to build a new pulp facility, given favorable geographic and climate conditions, land and forest availability, and its low-cost position. The expectation of a rapid deleveraging in the next few quarters could overcome the company's only obstacle in announcing a new plant, in our view--leverage above what is defined in financial policy limits. We expect Suzano will adhere to its publicly disclosed financial limits, despite the potential construction of a new plant, keeping net debt to EBITDA below 3.0x amid regular conditions and below 3.5x during the investment phase.

According to our base-case scenario, which currently excludes an expansion investment, we expect the company to post annual free operating cash flow (FOCF) at R$12 billion - R$14 billion in 2022-2024. We estimate that a potential pulp facility would require $2 billion - $3 billion in investments for three years. As a result, we believe that the company's FOCF, coupled with external funding, would be sufficient to cover annual capital expenditures (capex) of R$4 billion – R$5 billion, while Suzano maintains its credit metrics within the financial policy guidelines.

The sovereign rating and transfer and convertibility (T&C) limitation. The export-oriented business, low sensitivity to domestic economy, and very comfortable liquidity position, with cash holdings and projected cash generation at more than 3.0x expected uses of cash in the short term, result in a higher rating on the company than the 'BB-' sovereign foreign currency rating on Brazil. Given that all of its producing assets are located in the country, we limit our rating on Suzano to one notch above our 'BB+' T&C assessment of Brazil. Therefore, the upgrade is by the T&C assessment, and any downward revision of it would ultimately result in a downgrade of Suzano.

Outlook

The stable outlook on Suzano reflects our expectation that it will benefit from better market conditions, posting strong FOCF. We expect the company to adhere to its financial policy and maintain a cautious approach towards investments and dividends distribution. This will allow further deleveraging, with net debt to EBITDA consistently below 3.0x.

Downside scenario

A negative rating action in the next 12-18 months could occur if Suzano's credit metrics don't improve as expected. This could likely come from a combination of weakening pulp prices and higher investments, which would reduce the expected FOCF. If the company announces a new investment in the next few quarters while pulp prices are consistently below $500 per ton, a downgrade is possible. In this scenario, we would see debt to EBITDA above 3.5x and funds from operations (FFO) to debt below 20% for the next two years. We could also lower the ratings if we revise downward our T&C assessment to 'BB' from 'BB+', given that we cap our ratings on Suzano at one notch above T&C. This could occur if we were to lower the sovereign rating to 'B+' from 'BB-'.

Upside scenario

The ratings on Suzano are constrained at the current level, one notch above the T&C assessment. An upgrade is also constrained by the pulp market's volatile nature and dependence on China's demand. Nevertheless, we could revise upward Suzano's stand-alone credit profile (SACP) in the next three years if we see a more prudent financial policy, resulting in the leverage metric closer to 2.0x and below 3.0x during the investment cycle.

Company Description

Suzano is the world's largest bleached eucalyptus kraftwood pulp (BEKP) producer--with a capacity of 11 million tons per year. The company is a leading player in Brazil's printing and writing paper market, with a total capacity of 1.4 million tons (including tissue capacity). The company has 10 pulp mills across Brazil, including ones in Sao Paulo, Bahia, Maranhão, Mato Grosso do Sul, and Espírito Santo. Some of these plants also produce paper. Suzano also holds a 50% interest in Veracel, a joint operation with Stora Enso, located in Bahia, which has market pulp capacity of 1.2 million tons. Suzano also benefits from access to proprietary rapidly growing forests, with more than 2.2 million hectares (with about 1.3 million hectares of planted forests).

Our Base-Case Scenario

- An average exchange rate of R$5.3 per $1 in 2021 and R$5.17 per $1 in 2022.
- The 2021 average listed BHKP prices (bleached hardwood kraft pulp) in China of $590 per ton and $790 per ton in Europe, up from $465 and $685 in 2020, respectively, and increasing about 5% in 2022, reflecting a better demand and supply balance in the global market.
- Our net realized price assumptions are R$3,080 per ton in 2021, R$3,020 per ton in 2022, and 2,930 per ton in 2023.
- The abovementioned prices incorporate a 27% average discount in the next few years.
- Annual pulp volumes sold of about 11 million tons, according to the company's current production capacity.
- Cash costs to remain between R$660 and R$700 per ton, raising adjusted EBITDA margins to 58%-62% in 2021 and 2022 from 41% in 2019 and 49% in 2020.
- Higher margins would stem from the weaker real, stronger pulp prices, and cost reductions stemming from synergies of Fibria's incorporation. The latter are due to lower selling, general, and administrative expenses (SG&A), and a broader forest portfolio that resulted in shorter distances between forests and mills, as well as in lower logistics costs.
- Investments slightly higher than maintenance levels, at about R$5 billion annually in 2021 and 2022.
- No dividend payment in 2021 and 25% of previous year's net income starting in 2022.

Key Metrics:

- EBITDA of R$21 billion - R$23 billion in 2021 and R$22 billion - R$24 billion in 2022, compared with R$14.9 billion in 2020;
- Debt to EBITDA below 3.0x in 2021, about 2.0x in 2022, and below 2.0x in 2023; and
- FFO to debt of 30%-35% in 2021, 35%-40% in 2022, and above 40% in 2023.

Sensitivity analysis

Although the company hasn't announced investment in a new pulp facility, we see its likelihood as very high after the leverage metric drops below 3.0x. We have run some sensitivity scenarios given additional investment of $2 billion - $3 billion in 2022-2024. This, along with our assumptions for pulp prices and FX, the company would still post net debt to EBIDTA below 3.0x in the three-year period. If market conditions worsen, with pulp prices returning to the 2020 average, net debt to EBITDA would peak to 3.5x-4.0x.

Liquidity

We are revising our assessment of Suzano's liquidity to exceptional, mostly due to the company's high cash holdings, lower debt costs, an extended amortization profile. We expect the company to maintain the sources-to-uses ratio above 2.0x in the next two years, despite a peak in historical working capital outflow as seen in the past few years and likely investment in a new pulp facility. In addition, we believe that Suzano has enough of a cushion to allow for a positive sources-to-uses ratio even if EBITDA drops 50%, as well as the ability to absorb high-impact events without refinancing. Moreover, the company has access to funding from several banks, and we perceive its standing in credit markets as favorable for the rating level, considering current bond yields. Finally, Suzano has recently benefited from prudent risk management, as seen in the high cash amount it held to weather the market volatility and its consistent debt refinancing.

Principal Liquidity Sources

- Cash reserves of R$9 billion as of December 2020;
- Stand-by credit facility of R$3.6 billion; and
- Annual FFO of R$17 billion - R$20 billion in 2021 and 2022.

Principal Liquidity Uses

- Short-term debt maturities of R$2 billion as of December 2020;
- Annual capex of R$5 billion for 2021 and 2022;
- Working capital outflows peaking at R$1.3 billion for the next 12 months; and
- No dividend payment in 2021 and about R$2.1 billion in 2022.

Covenants

The company has no financial covenants.

Issue Ratings - Subordination Risk Analysis

Capital structure

We currently rate several senior unsecured notes, either issued or guaranteed by Suzano.

Analytical conclusions

The ratings on Suzano's debt are the same as our issuer credit rating on the company, because it has limited secured debt. Even if this debt ranked behind the debt issued by subsidiaries in the capital structure, we believe the risk of subordination is mitigated by a priority debt ratio far less than 50% and the parent's considerable earnings. We rate the financing vehicles' unsecured debt the same as our issuer credit rating on Suzano based on the guarantee of this debt.

Ratings Score Snapshot

Issuer Credit Rating

- Global Scale: BBB-/Stable/--
- National Scale: brAAA/Stable/--

Business risk: Satisfactory

- Country risk: Moderately high
- Industry risk: Moderately high
- Competitive position: Satisfactory

Financial risk: Significant

- Cash flow/leverage: Significant

Anchor: bbb-

Modifiers

- Diversification/portfolio effect: Neutral (no impact)
- Capital structure: Neutral (no impact)
- Financial policy: Neutral (no impact)
- Liquidity: Exceptional (no impact)
- Management and governance: Fair (no impact)
- Comparable rating analysis: Neutral (no impact)
- Stand-alone credit profile : bbb-

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Corporates | General: Corporate Methodology: Ratios And Adjustments, April 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- Criteria | Corporates | General: Reflecting Subordination Risk In Corporate Issue Ratings, March 28, 2018
- Criteria | Corporates | General: Methodology And Assumptions: Liquidity Descriptors For Global Corporate Issuers, Dec. 16, 2014
- Criteria | Corporates | General: Corporate Methodology, Nov. 19, 2013
- General Criteria: Country Risk Assessment Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013

- General Criteria: Methodology: Industry Risk, Nov. 19, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities, Nov. 13, 2012
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Suzano S.A.		
Issuer Credit Rating	BBB-/Stable/--	BBB-/Negative/--
Ratings Affirmed		
Suzano S.A.		
Issuer Credit Rating		
Brazil National Scale	brAAA/Stable/--	
Suzano S.A.		
Senior Unsecured	brAAA	
Fibria Overseas Finance Ltd.		
Senior Unsecured	BBB-	
Suzano Austria GmbH		
Senior Unsecured	BBB-	

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.